KNYSNA

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Signature of Speaker	
Signature of MM	

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Knysna Municipality

Impact of Covid-19 on Knysna's Financial Sustainability

A New Worst Case Scenario

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INTRODUCTION AND BACKGROUND

"A well-run municipality advances the health of its citizens and the health of its citizens impacts on the financial sustainability of a municipality."

This report is an addendum to the report *Impact of Covid-19 on Knysna's Financial Sustainability*, dated April 2020. The CFO of Knysna Municipality provided an indication of the municipality's expected payment ratios and shared the views on the economic outlook provided by the Explore Knysna Tourism Association. The overall expectation of the impact of Covid-19 on the social- and economic environment is very negative. We subsequently ran another scenario, the New Worst Case Scenario.

KEY FINDINGS AND RECOMMENDATIONS

Key Findings of the New Worst Case Scenario

- Even with significant budgetary savings on a number of Operating Expenditure items, including Employee Related expenses, of close to R300 million during the 3 financial years 2020/21 to 2022/23, the municipality will not be able to generate sufficient cash to avoid an overdraft of close to R130 million in 2020/21.

Recommendations

- Monitor the cash flow daily and limit spending to the actual cash inflow, irrespective of budget.
- Amend the 2020/21 budget by freezing Employee Related Expenses to the levels of 2019/20, i.e. R290 million.
- Reduce the 2020/21 operating budget by a further R40 million unless this amount can be provided as grant from the fiscus.
- Prepare to adjust the 2020/21 operating budget downwards by a further R90 million pending on the extended impact of Covid-19.
- Prepare to adjust the MTREF by reducing the Employee Related Expenses for 2021/22 and 2022/23 to R290 million p.a.
- Approach the National Treasury with a request to assist the municipality with operating grant funding of R150 million.
- Prepare to adjust the MTREF by reducing the operating budget for 2021/22 by a further R40 million.
- Avoid giving rate payers and customers relief measures that will significantly reduce the cash inflow to the municipality. Where relief is granted, it should be in the form of delayed payments granted and no debt forgiveness should be considered.
- Review this Covid-19 impact assessment at the end of this 2019/20 financial year and update recommendations based on actual cash balances as at 30 June 2020.

Assumptions for the New Worst Case

GVA Decline

The growth/[decline] in the top 76% subsectors of the economy of Knysna was amended for purposes of the new Worst Case as recorded in the table below.

Table 1: Knysna: Impact of Covid-19 on the Top 76% Economic Subsectors

Economic Subsector	Proportion of Economic Output	Percentage decline (Effective p.a)
50 Construction	11.2%	-10.0%
62 Retail trade and repairs of goods	10.8%	-15.0%
81-83 Finance and Insurance	8.6%	-5.0%
84 Real estate activities	6.2%	-5.0%
85-88 Other business activities	6.0%	--10.0%
91 Public administration and defence activities	5.9%	0.0%
61 Wholesale and commission trade	5.3%	-10.0%
32 Wood and wood products	5.1%	-2.0%
94-99 Other service activities	4.7%	-10.0%
93 Health and social work	4.5%	0.0%
92 Education	3.9%	0.0%
64 Hotels and restaurants	3.8%	-50.0%

These growth rates translate to an overall effective decline in the GVA growth rate for Knysna of -7.1% p.a. for the assumed duration of the pandemic, as outlined for each scenario below, and subsequent ramp-up to Base Case conditions.

Affected Households

The total loss of formal employment opportunities will amount to 2 629 jobs. This represents 10.0% of the 26 227 employment opportunities reported in 2018.

Applying the Resilience factor, the total number of households affected in some way or another then numbers 1 762 households.

The additional number of households migrating to the indigent category is 223.

Payment Ratio

Based on the estimates provided by the CFO the Payment Ratios for the years were amended as follows:

2019/20 84.8%
2020/21 65.8%

Scenarios

In the "***New Worst Case***" scenario the Covid-19 impact commences in April 2020 for an extended period until the end of December 2021. Thereafter a full year of ramp up occurs to reach Base Case conditions at the end of December 2022.

Outcome of Scenarios

The outcome of the scenarios is presented in Table 2 below. ***This presents the outcome before remedial actions to counter the impact of Covid-19 on the municipality is implemented***. It also does not reflect any potential relief measures that the municipality offers to its customers.

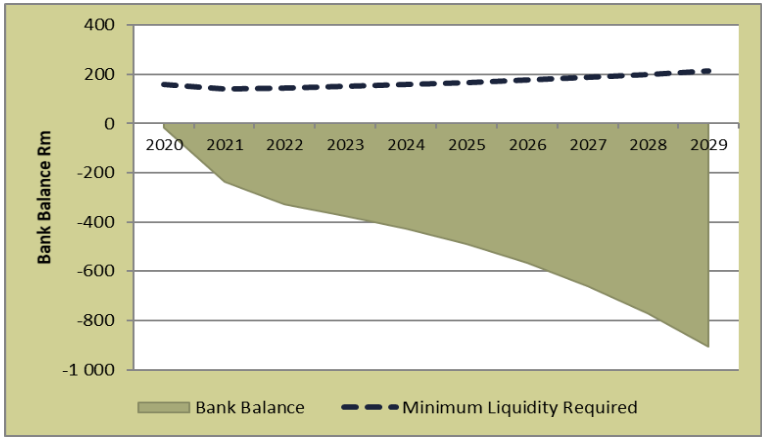
Table 2: Knysna: 10-Year outcome of Scenarios Before Remedial Measures

Outcome	Base Case	Best Case	Worst Case	New Worst Case
Average annual % increase in Revenue	7.2%	7.0%	6.8%	6.5%
Average annual % increase in Expenditure	7.1%	7.0%	7.1%	7.3%
Accounting Surplus accumulated during Planning Period (Rm)	R 667	R 455	R 236	**-R 458**
Operating Surplus accumulated during Planning Period (Rm)	R 262	R 50	**-R 169**	**-R 863**
Cash generated by Operations during Planning Period (Rm)	R 834	R 620	R 399	-R 303
Average annual increase in Gross Consumer Debtors	7.7%	8.1%	8.6%	11.2%
Cash and Cash Equivalents at the end of the Planning Period (Rm)	R 232	R 18	**-R 203**	**-R 905**

No of Months Cash Cover at the end of the Planning Period (Rm)	1.8	0.1	-1.6	**-7.0**
Liquidity Ratio at the end of the Planning Period	1.1 : 1	0.5 : 1	0.3 : 1	**0.2 : 1**

In the absence of any remedial measures, the bank balance in the New Worst Case scenario declines consistently to reach a negative balance of R905 million in 2029.

GRAPH 1: KNYSNA: BANK BALANCE: NEW WORST CASE SCENARIO



A selection of the average ratios for the 10-year planning period is presented in TABLE 3 below.

TABLE 3: KNYSNA: 10-YEAR AVERAGE RATIOS

Ratio	MFMA Norm	Base Case	Best Case	Worst Case	New Worst Case
Minimum Liquidity Level	1 – 3 months	1.5	0.3	0.0	0.0
Liquidity Ratio (Current Assets : Current Liabilities)	1.5 – 2: 1	1 : 1	**0.7 : 1**	**0.5 : 1**	**0.3 : 1**
Accounting Surplus R'000	Break even or >0	66 701	45 508	23 631	**-45 772**
Cash Operating Surplus R'000	n.a.	26 174	4 982	**-16 895**	**-86 298**
Net Operating Surplus / Total Operating Revenue	>= 0%	1.8%	0.1%	**-1.5%**	**-7.3%**

REMEDIAL MEASURES

The objective is to improve liquidity such that the bank balance reaches at least the level of the minimum required liquidity by 2029.

New Worst Case Scenario

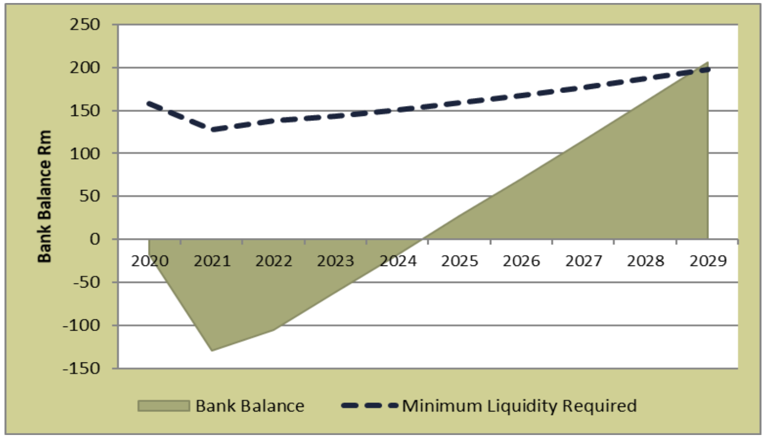
The proposed measures include the following:

- Employee related expenses need to be frozen for 3 financial years, viz. 2020/21 to 2022/23. This expenditure item must remain at its 2019/20 levels or lower. For the balance of the forecast period, the escalation of this expense item is assumed to remain at the levels used in the Base Case, albeit applied on a lower base value.
- Operating expenditure must be reduced by R130 million in 2020/21, typically through savings on Contracted Services, Repairs and Maintenance or Other Expenditure.
- Operating expenditure must be reduced by R40 million in 2021/22, typically through savings on Contracted Services, Repairs and Maintenance or Other Expenditure.

The graph below (

GRAPH 2) indicates that the objective of improving liquidity such that the bank balance reaches at least the level of the minimum required liquidity by 2029 may be achieved, but the municipality will only reach a cash neutral position in 2024. This after bottoming out at -R129 million in 2020/21.

GRAPH 2: KNYSNA: BANK BALANCE: NEW WORST CASE SCENARIO AFTER REMEDIAL MEASURES



Conclusion

Even with significant budgetary savings on a number of Operating Expenditure items, including Employee Related expenses, of close to R300 million during the 3 financial years 2020/21 to 2022/23, the municipality will not be able to generate sufficient cash to avoid a overdraft of close to R130 million in 2020/21.

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